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TO RUEHC/SECSTATE WASHDC 1242  
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INFO RUCPDOC/USDOC WASHDC  
RUEHBK/AMEMBASSY BANGKOK 3338  
RUEHBJ/AMEMBASSY BEIJING 5457  
RUEHUL/AMEMBASSY SEOUL 7955  
RUEHGP/AMEMBASSY SINGAPORE 6519  
RUEHKO/AMEMBASSY TOKYO 7854  
RUEHML/AMEMBASSY MANILA 9764  
RUEHJA/AMEMBASSY JAKARTA 3890  
RUEHKL/AMEMBASSY KUALA LUMPUR 3531  
RUEHHI/AMEMBASSY HANOI 3101  
RUEHBY/AMEMBASSY CANBERRA 4253  
RUEHWL/AMEMBASSY WELLINGTON 1532  
RUEHHK/AMCONSUL HONG KONG 6665  
RUEHGH/AMCONSUL SHANGHAI 0254  
RUEHGZ/AMCONSUL GUANGZHOU 9434

UNCLAS SECTION 01 OF 02 TAIPEI 002493

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STATE PLEASE PASS AIT/W AND USTR  
STATE FOR EAP/TC, EAP/EP  
USTR FOR WINTER AND WINELAND  
USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER  
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT  
TREASURY FOR OASIA/LMOGHTADER  
TREASURY PLEASE PASS TO OCC/AMCMAHON  
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF  
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

TAGS: [EINV](#) [EFIN](#) [ECON](#) [PINR](#) [TW](#)

SUBJECT: ChinaTrust Bank Chairman Jeffrey Koo Penalized

#### SUMMARY

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¶1. On July 20, Taiwan's Financial Supervisory Commission (FSC) ruled that ChinaTrust Financial Holdings (CFH) and CFH's subsidiary ChinaTrust Commercial Bank (CCB) violated regulations in their acquisition of equity shares in Mega Financial Holdings. The violations included failure to disclose CCB Hong Kong's existing ownership of 440 million Mega shares, as required by Taiwan regulations. The FSC fined CCB, required CFH to sell its Mega equity shares, and ordered Jeffrey Koo, Jr., to step down as Chairman of CCB. CFH share prices have fallen, along with hopes of significant consolidation in Taiwan's banking sector. END SUMMARY.

#### Earlier Penalties

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¶2. On June 27, the FSC imposed two penalties on CFH and CCB for unreported trading in overseas structured bonds through which CCB acquired nearly 4% of ownership in Mega. First, the FSC prohibited CCB from setting up new overseas offices and CFH from future investment in other financial institutions. Second, the FSC prohibited CFH and CCB from raising additional capital for merger or acquisition purposes.

#### Additional Penalties

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¶3. On July 20, the FSC imposed another six penalties after discovering that CFH and CCB had committed additional violations of disclosure regulations. The FSC:  
--ordered CFH to end Jeffrey Koo's role as Chairman;  
--ordered CFH to penalize other responsible executives and officers

of CFH and CCB;  
--fined CCB NT\$10 million (US\$307,692);  
--restricted for one year CCB's Hong Kong branch from trading in derivatives linked to stock prices;  
--required CFH to sell 440 million Mega shares; and  
--required CFH to dissolve arrangements it made for irregular trading of structured bonds.

#### Violations

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¶4. In January 2005 CCB received FSC permission to issue US\$500 million of bank debenture to serve as lending funds. However, CCB used US\$390 million of the fund raised to buy overseas structured bonds, without obtaining the FSC's prior permission or prior reporting to the FSC.

¶5. In September 2005, CCB's board authorized CCB's Hong Kong branch to buy US\$260 million of structured bonds linked to a basket of stocks in Taiwan, Hong Kong, Japan, and South Korea. A December 2005 CCB board resolution authorized CCB to buy another US\$130 million of structured bonds also linked to stocks in these four economies. However, the FSC found that the purchases of structured bonds were actually executed by CCB (Taipei), rather than by CCB's Hong Kong branch, and the structured bonds were not linked to a basket of stocks as authorized, but linked only to Mega equity stocks.

¶6. The FSC found that the CCB illegally sold the US\$390 million of structured bonds in January 2006 without required authorization of CCB's board. The sales were executed based on the personal instructions of CCB Chairman Jeffrey Koo, Jr. In addition, CCB did not follow proper internal risk control practices when it sold the

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bonds.

#### Impacts

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¶7. The Koo family financial empire uses CFH to run the largest privately-owned network of banks in Taiwan. The FSC's penalties highlight CFH's poor corporate governance and have prompted foreign portfolio investors to downgrade investment ratings for CFH. Paribas Securities has lowered the targeted CFH share price by 25% from NT\$28.6 to NT\$21.6. On Taiwan's stock market, the CFH share price has declined from NT\$27.1 to NT\$24.5 so far in July. In addition, the FSC's penalties have put an end to CFH's plan to merge with Mega and will likely dampen enthusiasm for much needed bank consolidation.

Young